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No. 85-1873

In the Supreme Court of the United States

OCTOBER TERM, 1986

WARD TRUMAN JONES, ET AL., PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

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QUESTION PRESENTED

Whether the conduct that formed the basis for petitioners' convictions was protected by the First Amendment.

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OPINION BELOW

The opinion of the court of appeals (Pet. App. A1-A6) is not reported.

JURISDICTION

The judgment of the court of appeals was entered on January 28, 1986. A petition for rehearing was denied on February 26, 1986 (Pet. App. B1). The petition for a writ of certiorari was filed on May 14, 1986, and is therefore out of time under Rule 20.1 of the Rules of this Court. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

Following a jury trial in the United States District Court for the Northern District of Texas, petitioners were convicted on one count of conspiracy to defraud the United States by impeding, impairing, obstructing, and defeating

the lawful functions of the Internal Revenue Service (IRS), in violation of 18 U.S.C. 371. Petitioner Ward Truman Jones (Truman) was also convicted on 14 counts of willfully aiding and assisting in the preparation and presentation of false tax returns, in violation of 26 U.S.C. 7206(2), and on one count of criminal contempt of court, in violation of 18 U.S.C. 401(3). Petitioner Jessie Jones (Jessie) was charged in seven of the aiding and assisting counts and convicted on one, and petitioner Joe Bledsoe was charged in and convicted on 10 of those counts. Pet. App. A2, A4. Truman was sentenced to 25 years' imprisonment, to be followed by two three-year periods of probation (R. 322-323, 326-327). Jessie and Bledsoe were each sentenced to five years' imprisonment (R. 324-325). The court of appeals affirmed (Pet. App. A1-A6).

1. The evidence at trial showed that between 1978 and 1981 petitioners, through their company (AFE), were in the business of selling *inter vivos* trusts. Truman represented to prospective customers that they could legally reduce their income taxes by assigning their property and earnings to such a trust. A customer would set up a trust with himself and Truman as the trustees, convey his home and personal property to the trust, and assign his wages or salary to the trust. Pet. App. A2-A3. The customer would continue to exercise complete control over his property and income, however; the trust would not direct his employment or spending and would not affect his lifestyle (II Tr. 543, 606).[1] Approximately 350 individuals purchased trusts from AFE for fees ranging between $1,500 and $3,500, plus fees for "maintenance" and tax return preparation (IV Tr. 969; VI Tr. 1201).

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[1]Transcript citations are taken from the government's brief in the court of appeals.

At tax time, accountants under Bledsoe's supervision would prepare individual (Form 1040) and trust (Form 1041) returns for customers, which Bledsoe personally reviewed (II Tr. 449, 451, 606; III Tr. 635-636, 654-655, 733-734, 737; IV Tr. 913, 916-917). All of the purported income of a customer's trust would be reported on his trust return, and deductions would be claimed for a variety of items that may not be deducted by an individual, such as depreciation on the customer's house, utility bills, and car payments. Management fees paid by the trust to the customer would also be deducted. Any remaining money would be reported as a distribution to named persons, usually close relatives of the customer, even though no money would actually have been distributed. On the customer's individual return, the earnings shown on his W-2 would be reported. But the income thus reported would be "adjusted" by a large negative amount styled "nominee income." This adjustment was the basis for the substantive counts of the indictment. Pet. App. A3-A4.

2. The court of appeals affirmed petitioners' convictions (Pet. App. A1-A6). The court of appeals summarily rejected petitioners' contentions that their convictions violated the Free Speech Clause of the First Amendment, that the evidence was insufficient to support the convictions, that the trial court erred in excluding testimony of a defense expert witness, and that the trial court's instructions were faulty (*id.* at A5-A6).

ARGUMENT

Relying on *United States* v. *Mallas*, 762 F.2d 361 (4th Cir. 1985), and *United States* v. *Dahlstrom*, 713 F.2d 1423, 1428 (9th Cir. 1983), cert. denied, 466 U.S. 980 (1984), petitioners contend (Pet. 9-12) that the tax law with respect to the validity of their trusts was unsettled and therefore that their advocacy of the trusts as a means of reducing

taxes was protected by the First Amendment. As the court of appeals held (Pet. App. A5), this contention is frivolous.

Assuming arguendo that *Mallas* and *Dahlstrom* were correctly decided, they lend no support to petitioners' claim. In *Mallas*, the court found that the question of the validity of a particular tax shelter was sufficiently unsettled that the defendants lacked the requisite criminal intent to be convicted of tax evasion. *Mallas* did not even address any First Amendment implications of vagueness or uncertainty in the law. In *Dahlstrom* the court also held that the shelter scheme involved there was not clearly illegal at the time the defendants entered into it and hence the requisite criminal intent was not shown. The court further noted that the First Amendment protected the defendants' advocacy of the shelter scheme unless it was directed at producing immediate lawless action (713 F.2d at 1428). These cases are inapposite here because in this case existing legal authority made it clear that petitioners' tax shelter scheme was invalid. And petitioners plainly have no entitlement to First Amendment protection because their conduct went well beyond mere advocacy and amounted to direct participation in the unlawful conduct. See *United States* v. *Little*, 753 F.2d 1420, 1433-1434 (9th Cir. 1984).

Long before the period that is the subject of this prosecution, this Court had repeatedly held that income is taxed to the person who earns it and that, for tax purposes, otherwise valid contractual arrangements are not effective to divert income from that person to another person or entity. See, *e.g.*, *United States* v. *Basye*, 410 U.S. 441, 449-450 (1973); *Harrison* v. *Schaffner*, 312 U.S. 579 (1941); *Helvering* v. *Horst*, 311 U.S. 112 (1940); *Lucas* v. *Earl*, 281 U.S. 111 (1930). In addition, both before and during this time period, numerous decisions of other courts and an IRS Revenue Ruling had held that trust arrangements similar to those involved here could not be used to avoid income tax.

See *Vnuk* v. *Commissioner*, 621 F.2d 1318 (8th Cir. 1980); *Horvat* v. *Commissioner*, 49 T.C.M. (P-H) para. 80,266 (1980); *Markosian* v. *Commissioner*, 73 T.C. 1235 (1980); *Wesenberg* v. *Commissioner*, 69 T.C. 1005 (1978); *Horvat* v. *Commissioner*, 46 T.C.M. (P-H) para. 77,104 (1977), aff'd, 582 F.2d 1282 (7th Cir. 1978), published at 671 F.2d 990 (1982), cert. denied, 440 U.S. 959 (1979); *Damm* v. *Commissioner*, 46 T.C.M. (P-H) para. 77,194 (1977); Rev. Rul. 75-257, 1975-2 C.B. 251.

Moreover, it was clear from the "grantor trust" provisions of the Internal Revenue Code, 26 U.S.C. 671-679, that petitioners' trust arrangements could not legitimately be used to avoid tax. Under these provisions, a grantor of a trust who has retained certain powers that may be exercised without the approval or consent of an adverse party is treated as the owner of the trust and is subject to tax on the trust's income. Given the complete control a purchaser of one of petitioners' trusts retained over his property and income, these provisions were clearly applicable and made the income assigned to the trust taxable to the individual. See, *e.g.*, *Vnuk* v. *Commissioner*, 621 F.2d at 1321. Thus, petitioners' claim of uncertainty in the tax law is totally without merit.[2]

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[2]For the same reason, there is no basis for petitioners' contention (Pet. 11, 12) that, because of uncertainty in the law, petitioners were not given fair notice of the requirements of the law and "necessarily lacked the requisite intent to violate the law." The record shows that petitioners were familiar with the relevant authorities. Copies of several of the decisions and the Revenue Ruling cited above were found in AFE's offices during a search in early 1983 (IV Tr. 954, 962; GXs 27-32). Also found in the offices were several newspaper articles reporting that trust arrangements like those promoted by petitioners had been rejected by the IRS as a valid method of reducing taxes (V Tr. 1080-1095; VI Tr. 1234-1235; GXs 34, 35, 39, 43, 45) and letters sent to Truman by attorneys advising that the trust promoted by petitioners could not be used as a legitimate means of tax avoidance (V Tr. 1111-1113; GXs 118, 119). Despite petitioners' awareness of the law, Truman told prospective customers they could rest assured that the trust petitioners sold was

Petitioners' attempt (Pet. 11-12) to characterize their conduct as mere advocacy protected by *Brandenburg* v. *Ohio*, 395 U.S. 444 (1969), is frivolous. Truman was appointed a trustee of the trusts set up by petitioners' customers, and petitioners provided tax return preparation services to their customers. These activities plainly involved participation in unlawful conduct, not simple advocacy. Consequently, they were not protected by the First Amendment. See, *e.g.*, *United States* v. *Holecek*, 739 F.2d 331, 334-335 (8th Cir. 1984), cert. denied, No. 84-5373 (Feb. 19, 1985); *United States* v. *Little*, *supra*; *United States* v. *Damon*, 676 F.2d 1060 (5th Cir. 1982).[3]

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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lawful and could not be challenged by the IRS, because it was just like trusts used by Bing Crosby, the Getty family, the Rockefellers, members of Congress, and Justices of the Supreme Court (V Tr. 747).

[3]Petitioners' brief contention (Pet. 12-13) that the trial court erred in not allowing them to present an expert witness to testify concerning the state of tax law was correctly rejected by the court of appeals. In light of the ample precedent establishing that their trust arrangement was not a legitimate means of tax avoidance, there can be little doubt that the trial court did not abuse its discretion in excluding such "expert" testimony.